

**The Examination Quality Measurement
System Program Can Be Enhanced**

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MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

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FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Examination Quality Measurement
System Program Can Be Enhanced (Audit # 200230021)

This report presents the results of our review of the Internal Revenue Service's (IRS) Examination Quality Measurement System (EQMS) Program. The overall objective of this review was to determine whether the EQMS Program is effective to measure the quality of the Examination function's work and if the results are used to improve overall effectiveness.

The EQMS Program is the Small Business/Self-Employed (SB/SE) Division's process to measure examination quality and assess long-term trends of performance, in keeping with the IRS' balanced measures. The EQMS Program's results are used to identify national trends, system changes, and training needs; to establish baselines; and to provide an understanding of the quality of examinations. The EQMS Program is responsible for conducting reviews of a statistically valid sample of completed examination cases, based on certain standard criteria. During Fiscal Year (FY) 2001, the EQMS Program reviewed 14,075 cases.

The SB/SE Division's Examination function is effectively using the EQMS Program results to help improve overall examination quality. For example, a group manager in one area office contributed articles to a territory office newsletter informing revenue agents which standards/issues they need to focus on to improve their case closures, based on the EQMS Program's results. Also, some area directors and territory managers prepared action plans to identify areas to improve the quality of examinations. Based on the most recent EQMS Program reports, the Examination function's overall quality improved by 5 percent for field examination cases and 1 percent for office examination cases from the end of FY 2001 through the first 3 quarters of FY 2002.

However, we identified four areas in which the EQMS Program could be improved. First, the EQMS Program did not identify the complete population of qualified, completed examinations that should have been subject to the sampling process. Only 38 percent of the EQMS Program-qualified field examination cases, and only 51 percent of the EQMS Program-qualified office examination cases, were actually selected for review from the 3 area offices we visited. As a result, the EQMS Program results were not statistically valid, since each case did not have an equal chance of being selected for review. In addition, EQMS Program management did not adequately document or monitor the sampling process or make periodic adjustments to the sample size when needed.

Second, the number of cases actually reviewed nationwide by the EQMS Program in FY 2001 was approximately 3,400 more than required to produce statistically valid results. The additional hours needed to review these returns could have been put to better use in examining tax returns. Based on an average time of 5 and 2.5 hours, respectively, to review a field case and an office case, and based on Examination function statistics for FY 2001, we estimate an additional 800 tax returns could have been examined, producing additional assessments of about \$9.8 million in tax liabilities in FY 2001. The decline in the number of examinations conducted has been a concern of the Congress and the IRS Oversight Board in the past several years. Taking the staff hours needed to conduct these excess EQMS Program case reviews and using them, instead, to conduct actual examinations of tax returns would help alleviate this concern. The IRS has recently changed its approach regarding the type of tax returns it will be examining. It has aligned its strategic priorities to address six specific areas of non-compliance. Therefore, the results from shifting the resources from quality reviews to conducting examinations may differ from FY 2001 statistics.

Third, the SB/SE Division's plan to make the EQMS Program results statistically valid at the territory office level, rather than at the current area office level, will greatly increase the resources needed to conduct the case reviews. The total statistically valid area office sample size would need to be increased by about 400 percent to make territory results statistically valid, requiring approximately 110 additional EQMS Program reviewers.

Finally, neither the examiners nor their group managers receive individual feedback from the EQMS Program reviewers concerning problems identified with the quality of their cases. Twelve of 14 area directors, territory managers, group managers, and Technical Support managers we interviewed believe that individual feedback is crucial for individual examiners to improve examination case quality.

We recommended the Director, Compliance, SB/SE Division, resubmit the previously rejected Request for Information Services (RIS) to automate the sampling process to help ensure all qualified cases are subject to review, thus helping promote statistical validity. Until such time when electronic sampling is implemented, the Director, Compliance, SB/SE Division, should re-emphasize the EQMS Program criteria and the need for reviews so that all cases meeting the criteria are being properly identified. In addition, the Director, Compliance, SB/SE Division, should establish and document an

approved sampling plan that provides for statistical validity, as well as monitor and periodically evaluate the plan to make any appropriate revisions. The Director, Compliance, SB/SE Division, should ensure that only the number of cases that constitute a statistically valid sample are reviewed and evaluate the impact that valid territory office statistical sampling would have. Finally, while we understand past agreements with the National Treasury Employees Union (NTEU) prevent individual feedback to examiners, it could be a very effective training tool. Therefore, the Director, Compliance, SB/SE Division, should consider providing this type of feedback after resolving this issue with the NTEU.

Management's Response: The Commissioner, SB/SE Division, agreed that they must improve the EQMS Program. SB/SE Division management recognized the need for an automated system and submitted a RIS on October 10, 2002, to request automation support. The Compliance Support Design Team is also considering automating the EQMS sampling process. SB/SE Division management will re-issue the sampling procedures and expectations to all Case Processing sites. They will provide training and assistance visits to the Case Processing sites to ensure consistent and correct application of the sampling procedures.

SB/SE Division management will maintain a documented sampling plan at all times, monitor the sampling process, and make any necessary periodic adjustments. Additionally, they will re-evaluate the impact statistically valid territory level sampling will have on staffing levels. This evaluation will include a discussion of the impact on balanced measures.

Finally, they agreed with the need to share as much feedback with the examiners as possible and to pursue resolution of this issue with the NTEU. In the interim, all levels of SB/SE Division management will review the results of the EQMS Program and share them generally with the examiners to improve performance.

While agreeing with our recommendations, SB/SE Division management disagreed with our conclusion about the revenue impact of reviewing more cases than the sample required. Management's complete response to the draft report is included as Appendix VI.

Office of Audit Comment: Although SB/SE Division management agreed with the report's recommendations and plans to take appropriate corrective action, they do not agree with the revenue impact of using EQMS Program resources to examine tax returns. SB/SE Division management stated that they assign reviewers in the EQMS Program for a specified period of time; they do not shift reviewers between reviewing and examining returns. Their reviewers are also responsible for providing support to the field in understanding the EQMS Program standards and applications through making presentations, attending group meetings, and conducting various other activities. The Compliance initiatives in the FY 2003 Business Plan require examination of more complex returns, which would require even more in-depth reviews than those conducted during the period the audit report covered.

We agree that shifting reviewers throughout the year between reviewing and examining returns would not be prudent. At the beginning of each year, however, management

should be able to use their sampling plan to determine the number of returns that need to be reviewed based upon the number of returns planned for examination in the Annual Examination Plan. If all existing EQMS Program resources are not needed to review those returns and provide support to the field, this is an opportunity for the IRS to conduct additional examinations of tax returns.

Copies of this report are also being sent to IRS officials who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Parker F. Pearson, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (410) 962-9637.

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The Examination Quality Measurement System Program Can Be Enhanced

Background

The Internal Revenue Service (IRS) Examination function is a nationwide program that selects and examines Federal tax returns to determine taxpayers' correct liabilities.

Examinations are conducted at the "field" and "office" levels. Field examinations involve individuals, partnerships, and corporations and generally occur at the taxpayer's place of business. Office examinations usually involve individuals and are conducted through interviews at an IRS office.

The Examination Quality Measurement System (EQMS) Program is the Small Business/Self-Employed (SB/SE) Division's process to measure examination quality and assess long-term trends of performance. The EQMS Program is part of the IRS' balanced measures process that includes customer satisfaction, employee satisfaction, and business results. The EQMS Program's results are not used to evaluate individual employee performance. Instead, they are to be used to identify national trends, system changes, and training needs; to establish baselines; and to provide an understanding of the quality of examinations.

Approximately 59 EQMS Program reviewers are located in 9 offices nationwide. These employees conduct reviews of completed examination cases and provide data to the Office of Performance Analysis, which in turn provides results data to the area offices. During Fiscal Year (FY) 2001, the EQMS Program reviewed 14,075 cases, including 6,879 field examination and 7,196 office examination cases. A case is defined as either an examination of one return for a taxpayer or any group of multiple year returns and/or related returns closed as a related package. Random sample selection is used to help ensure the reliability of the results.

Cases are reviewed to assess adherence to established quality standards. Quality standards are concise statements of expectations for quality examinations and are guidelines to assist examiners in fulfilling their professional responsibilities. The eight standards essentially define "quality" for examinations and provide objective criteria against which case quality is evaluated. They address planning, scope of examination, income probes, techniques, workpapers and reports, tax law application, time

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management, and customer relations. Each quality standard is defined by elements representing components that are present in a quality examination.

At the time of our review, the EQMS Program was organizationally placed in the Office of Performance Measurement (Compliance) and reported to the Office of Strategy, Research, and Performance Measurement (SRPM). However, as of June 1, 2002, Performance Measurement (Compliance) was moved to the SB/SE Division's Compliance function.

We visited the Chicago, Los Angeles, and Detroit Area Offices where we interviewed Examination and Case Processing management. We also interviewed EQMS Program management in Buffalo, New York, and Los Angeles, California, and at the SB/SE Division's Headquarters office. We conducted the audit between February and July 2002 in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Examination Quality Measurement System Results Were Being Used Effectively

The SB/SE Division's Examination function is effectively using the EQMS Program's results to help improve overall examination quality. Based on the most recent EQMS Program reports, the Examination function's overall quality score improved by 5 percent for field examinations and 1 percent for office examinations from the end of FY 2001 through the first 3 quarters of FY 2002.

We compared the EQMS Program standards to the SB/SE Division's strategic goals for FYs 2002 and 2003 and the Critical Job Elements (CJE) for revenue agents (field) and tax compliance officers (office). The EQMS Program standards adequately supported the IRS business results measures and the CJE.

We visited two EQMS Program sites and determined they were timely reviewing and providing results to Examination function management. The EQMS Program goal is to assign the cases to reviewers within 60 days of receipt and to complete the reviews within 30 days of the assignment.

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Our analyses in 2 EQMS Program offices showed that they were generally assigning cases to reviewers within a 60-day period. Our review of inventory reports in 1 EQMS Program office showed that 81 percent of the cases were reviewed within 30 days and 98 percent were reviewed within 45 days. In addition, the EQMS Program submits completed review results to the SRPM office once a month and makes them available to SB/SE Division management within 5 to 10 days of receiving them.

The EQMS Program has several internal methods for ensuring the quality of its own reviews. The EQMS Program managers and reviewers periodically meet and conduct consistency checks to help ensure reviewers are uniformly applying the quality standards. Reviewers and managers discuss specific elements and case scenarios and independently evaluate the same case, discuss the ratings, and critique the review process. In the area offices we visited, EQMS Program management had also provided on-site guidance/training on proper sample selection procedures for case processing employees.

The SB/SE Division's Examination function managers in the three area offices we visited were actively involved with the improvement of examination quality. Some of the actions taken as a result of the EQMS Program reviews included:

- Some area directors and territory managers prepared action plans to identify areas to improve the quality of examinations. Some also periodically conducted workload and operational reviews.
- A group manager in one area office contributed articles to her territory's newsletter to inform the revenue agents which standards/issues they need to focus on to improve their case closures.
- One area director conducted a town hall meeting and discussed the EQMS Program results and plans to improve quality in examinations.

The SRPM office also plays a role in improving examination quality. For example, SRPM office staff

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reviewed the narratives pertaining to all the cases that did not meet the standard involving report preparation in FY 2001. To help improve on this standard, they issued a number of quick fixes/job aids for the examiners to follow prior to closing cases. The SRPM office also developed a website where the EQMS Program results are accessible to more IRS employees and can be obtained at more frequent intervals (monthly) than before. In addition, it prepares a quarterly report that gives an analysis of the quality standards and includes recommendations to improve examination quality. The SRPM office also produces a national EQMS Program newsletter that gives procedures and methods for improvements when quality standards are not being met.

Finally, Technical Support liaisons analyze the EQMS Program results and issue quarterly reports to Examination function management for their specific areas. A National Task Force was convened and developed a standardized report format for the EQMS Program results to provide consistency of reporting to Examination managers. The standardized report includes: a table of area office results by standards and elements, an illustrative area office chart, a table of territory office results by standards and elements for each territory manager, and a report of reviewer narratives for each territory manager. Managers can also request optional reports containing more detailed analysis of the EQMS Program results.

Examination Quality Measurement System Results Were Not Statistically Valid

The EQMS Program did not identify the complete population of qualified, completed examinations that should have been subject to the sampling process. Therefore, each case did not have an equal chance of being selected for review. As a result, the EQMS Program results were not statistically valid. In addition, EQMS Program management did not adequately document or monitor the sampling process or make periodic adjustments to the sample size when needed.

Not all the EQMS Program-qualified cases were identified for sampling

The EQMS Program reviews randomly selected cases to collect information from completed examinations. Most

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types of examined income tax return cases qualify for the EQMS Program review. However, unexamined (surveyed) income tax returns and examined estate, gift, excise, and some employment tax returns do not qualify for EQMS Program review.

The EQMS Program set out to select and review a statistically valid random sample of cases because it was not physically and economically possible to review 100 percent of the population. Examining a statistically valid sample of a universe allows one to make conclusions about the universe based on information from the sample. A random sample is one that seeks to represent, as closely as possible, the population from which it was drawn. Random sample selection means that every item in the population has an equal chance of being selected.

The sample size originally established for the EQMS Program called for selecting 1 in every 25 completed field examination cases and 1 in every 30 completed office examination cases. Management advised us that due to a decrease in the number of closed examinations and problems with implementation of the sample selection procedures, the number of cases being sampled and submitted for EQMS Program review was not adequate. In an effort to increase the number of cases sampled and submitted for review, revised procedures went into effect October 1, 2000, increasing the sample size to 1 in 3 for field examination cases and 1 in 5 for office examination cases.

To determine whether sampling procedures were adequate, we analyzed the Examination function's file of closed examinations generated from the Audit Information Management System (AIMS)¹ for the three offices we visited. We also reviewed the EQMS Program reports for FY 2001 to identify the number of cases the EQMS Program actually reviewed.

We estimate that, in FY 2001, the SB/SE Division in these 3 area offices conducted 8,200 field and 15,500 office

¹ The AIMS is a computer system designed to give the Examination function information about returns in inventory and closed.

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examination cases that met the EQMS Program review criteria. If the 1 of 3 and 1 of 5 selection plan was used, the number of cases selected should have been about 2,700 (field) and 3,100 (office). However, only 1,016 field cases and 1,594 office cases were actually selected for review, 38 and 51 percent of what should have been selected, respectively.

To further evaluate the adequacy of the case selection process, we requested the Case Processing function in 2 area offices to set aside all the EQMS Program cases for a 1-day period that they determined did not meet EQMS Program review criteria. Case Processing units in the area offices are responsible for identifying and processing cases for the EQMS Program sample. The Case Processing staff identified 19 cases not meeting EQMS Program criteria.

Our review of these 19 cases determined that 6 (32 percent) should have been included in the population, since they met the EQMS Program criteria. Case Processing management agreed that these six cases should have been included in the population and informed us that some of their personnel were new to the position. Also, one office was using an obsolete listing of the sample selection criteria.

Technical Support liaisons in area offices are responsible for monitoring the sampling process to ensure that qualified cases are properly selected in accordance with prescribed EQMS Program procedures, and that the sample is selected timely, continuously, and at the proper selection rate.

However, the Technical Support liaison in one area office did not conduct any reviews to ensure all EQMS Program-qualified cases were identified during the sampling process.

Management recognized the inherent risks associated with a manual sample selection process, including human error, which could make their results not statistically valid. They submitted a Request for Information Services (RIS) in November 2000 to automate the sample selection process. However, the RIS was rejected due to the priority of other RISs received and limited resources.

The EQMS Program sampling process was not adequately documented

The EQMS Program did not adequately document the steps followed in establishing a sampling plan. In addition, the staff did not adequately monitor the sampling process or make appropriate periodic adjustments to the sample size, such as when the expected population of cases decreased. Management advised us they did not have a documented plan. Not having a documented plan, and not making the necessary and timely adjustments to it, can lead to invalid results.

According to the IRS' Statistical Sampling Handbook, sampling guidelines require documenting the sequence of steps that are taken to arrive at desired sample results. The process should begin by establishing and defining, as precisely as possible, the objectives of the program to be sampled. Then the targeted population from which the sample will be drawn needs to be identified.

The next step in the sampling process is to develop a sampling plan, which includes determining:

- The sampling scheme to be used (judgmental, statistical, etc.).
- How the data are to be gathered (manually, electronically, etc.).
- The sample size that is needed.
- How the data are going to be evaluated.

After the sampling plan has been prepared, the final steps in the sampling process are the actual selection of the sample, review of sample items, and evaluation of the results. The sample process should be monitored periodically to determine if it is producing the required results and to make any necessary adjustments that are required.

Recommendations

The Director, Compliance, SB/SE Division, should:

1. Resubmit the RIS to automate the sampling process to help ensure all qualified cases are subject to review, thus helping to promote statistical validity. The RIS should contain a business case explaining that such a selection process is necessary to ensure that the SB/SE Division can meet its goal of adequately measuring its business results under the balanced measures concept.

Management's Response: EQMS Program management recognized the need for an automated system and submitted a RIS on October 10, 2002, to request automation support. In addition, the Compliance Support Design Team is considering automating the EQMS Program sampling process.

2. Until such time when electronic sampling is implemented, re-emphasize the criteria for cases qualifying for EQMS Program sampling and the need for reviews so that all cases meeting the criteria are being properly identified.

Management's Response: The Director, Case Management, will re-issue the sampling procedures and expectations to all Case Processing sites. The Director, Case Management, assisted by the Director, Strategy-Research Performance Management, will provide training and assistance visits to the Case Processing sites to ensure consistent and correct application of the sampling procedures.

3. Establish and document an approved sampling plan that ensures statistical validity, periodically evaluate the plan, and make appropriate revisions.

Management's Response: The EQMS Program Manager will maintain a documented sampling plan at all times. The Director, Case Management, SB/SE Division, will monitor the sampling process with assistance from the Office of Centralized Workload Selection & Delivery and Performance Excellence and make any necessary periodic adjustments.

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More Cases Were Being Reviewed Than Required for Statistical Validity

As stated previously, the EQMS Program revised the sample size in October 2000 to select 1 in 3 field and 1 in 5 office examination cases. The EQMS Program management did not adequately monitor the sampling process and revised the sampling procedures without using a statistically valid plan to determine the appropriate sample size needed, thereby resulting in the over-sampling of cases.

We analyzed the SB/SE Division Examination function's closed case populations for 15 area offices (the International Office was not included) for both field and office examinations. Even though all EQMS Program-qualified cases were not being selected for quality review, we determined that the actual sample taken for FY 2001 was about 3,400 cases larger than necessary to produce statistically valid results. Had the EQMS Program actually reviewed one in three field and one in five office examination EQMS Program-qualified cases as planned, the impact would have been much greater.

Figure 1 shows the number of cases that the EQMS Program reviewed for the 15 area offices versus the number that would be required based on a statistically valid sampling plan. Statistically valid samples were determined for each of the 15 area offices and then added together.

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Figure 1 – Comparison of Actual Sample Taken to the Estimated Statistically Valid Sample

Field Examination	Number of Cases	Review Hours³
EQMS Program-Qualified Cases ¹	65,500	N/A
Actual Sample Taken	6,879	34,395
Statistically Valid Sample ²	5,300	26,500
Overage	1,579	7,895
Office Examination	Number of Cases	Review Hours
EQMS Program-Qualified Cases	103,500	N/A
Actual Sample Taken	7,196	17,990
Statistically Valid Sample	5,400	13,500
Overage	1,796	4,490

Source: Examination Closed Data File/FYs 2000 & 2001.

¹ Since FY 2000 closed examination data could not be broken down into area populations, we used FY 2001 closed examination data and increased field area populations by 35 percent and office area populations by 30 percent to simulate the FY 2000 population size.

² Statistically valid samples were based on the estimated FY 2000 population and a 95 percent confidence level, a plus or minus 5 percent precision rate, and an expected error rate of 50 percent.

³ A responsible management official indicated that the average times required to review an EQMS Program field case and an office case were 5 hours and 2.5 hours, respectively.

Selecting a statistically valid sample would allow the EQMS Program to be more economical by reviewing a minimum number of cases in the minimum amount of time necessary. In addition, the extra hours used to review the over-sampled cases could be put to better use by having examiners conduct additional examinations of tax returns. Based on an average time of 5 and 2.5 hours, respectively, for an EQMS Program reviewer to review a field and an office case, an estimated 12,400 hours could have been saved and used to examine tax returns. Using Examination statistics for FY 2001, we estimate that an additional 800 tax returns could have been examined, producing potential tax assessments of about \$9.8 million in tax liabilities in FY 2001. The IRS has recently changed its approach

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regarding the type of returns it will be examining. It has aligned its strategic priorities to address six specific areas of non-compliance. Therefore, the results from shifting the resources from quality reviews to conducting examinations may differ from FY 2001 statistics.

The number of returns examined has been declining in recent years, which has been a concern of the Congress and the IRS Oversight Board. The Commissioner of the IRS has said the decline is due in part to the decline in available staffing. Using these additional hours for examining tax returns would help alleviate this concern.

Recommendation

4. The Director, Compliance, SB/SE Division, should ensure that the EQMS Program reviews only the number of cases needed to constitute a statistically valid sample.

Management's Response: The EQMS Program Manager will maintain a documented sampling plan at all times. The Director, Case Management, SB/SE Division, will monitor the sampling process with assistance from the Office of Centralized Workload Selection & Delivery and Performance Excellence and make any necessary periodic adjustments. **Note:** This is the same corrective action as that provided for Recommendation 3.

Office of Audit Comment: Although SB/SE Division management agreed with the report's recommendations and plans to take appropriate corrective action, they do not agree with the revenue impact of using EQMS Program resources to examine tax returns. SB/SE Division management stated that they assign reviewers in the EQMS Program for a specified period of time; they do not shift reviewers between reviewing and examining returns. Their reviewers are also responsible for providing support to the field in understanding the EQMS Program standards and applications through making presentations, attending group meetings, and conducting various other activities. The Compliance initiatives in the FY 2003 Business Plan require examination of more complex returns, which would require

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even more in-depth reviews than those conducted during the period the audit report covered.

We agree that shifting reviewers throughout the year between reviewing and examining returns would not be prudent. At the beginning of each year, however, management should be able to use their sampling plan to determine the number of returns that need to be reviewed based upon the number of returns planned for examination in the Annual Examination Plan. If all EQMS Program resources are not needed to review those returns and provide support to the field, this is an opportunity for the IRS to conduct additional examinations of tax returns.

Statistically Valid Examination Quality Measurement System Results at the Territory Level Will Result in the Need for Increased Resources

The current EQMS Program sampling plan is designed to produce results that are valid at the area office level. However, SB/SE Division management is considering making the EQMS Program results statistically valid at the territory office level.

A statistically valid sample at the territory office level will greatly increase the resources needed to conduct the case reviews. In fact, the sample size would need to be increased by about 400 percent to make territory office results statistically valid; the sample size would go from about 10,400 (for total area office samples) to approximately 53,500 (for total territory office samples), based on a 95 percent confidence level. Consequently, it would take approximately 110 additional EQMS Program reviewers to make the sampling statistically valid at the territory office level, compared to what would be needed at the area office level. Specific details of our analysis are presented in Appendix V.

These additional reviewers would likely come from the field and office examination programs, resulting in a significant reduction in examination staff and a decrease in the number of tax returns that could be examined. Increasing the number of cases to be quality reviewed would demand significant additional resources, which need to be balanced with the benefits to be gained.

Recommendation

5. The Director, Compliance, SB/SE Division, should evaluate the impact of having valid territory office statistical sampling, to ensure the expected benefits justify the additional resources that would be needed.

Management's Response: The SB/SE Division will re-evaluate the impact statistically valid territory level sampling will have on staffing levels. This evaluation will also include a discussion of the impact on balanced measures.

**Sufficient Feedback Was Not
Given to Examiners**

The EQMS Program returns completed examinations to individual examiners under certain circumstances, such as when there is a substantive tax effect (\$10,000 or more) or when a tax effect exists in the taxpayer's favor. However, of the eight standards that the EQMS Program reviews, there are various quality issues such as timeliness, customer relations, examination techniques, and workpapers on which individual feedback is not provided when these are the only exceptions noted.

The EQMS Program reviewers prepare narratives on those cases that do not meet any one of the eight quality standards. These narratives are available to territory level managers; however, neither the examiners nor their group managers are receiving individual feedback from the EQMS Program reviews.

Management informed us that results are not provided to employees based upon a past agreement with the National Treasury Employees Union (NTEU). However, 12 of 14 area directors, territory managers, group managers, and Technical Support managers we interviewed believe that individual feedback is crucial for examiners to improve examination case quality.

The Internal Revenue Manual states that the EQMS Program's results are to be used by Examination function management to identify system changes, training, and educational needs and to improve work processes. Area office responsibilities include identifying opportunities for

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improvement and then conducting quality improvement initiatives to affect the EQMS Program results.

While the EQMS Program reviews can identify problem trends that need to be addressed on a national or local level, individual examiners may be making errors that are unique to them. Consequently, they may continue to repeat them if not notified of the problem. Addressing the performance of individual examiners can help improve the quality of that individual's performance, which will result in an overall improvement in the quality of examination work.

Recommendation

6. The Director, Compliance, SB/SE Division, should consider providing individual feedback to examiners from the EQMS Program case reviews, after resolving this issue with the NTEU.

Management's Response: The Director, Compliance, SB/SE Division, agreed with the need to share as much feedback with the examiners as possible and will pursue resolution of this issue with the NTEU. In the interim, all levels of management will review the results of the EQMS Program and share them generally with the examiners to improve performance.

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Examination Quality Measurement System (EQMS) Program is effective to measure the quality of the Examination function's work and if the results are used to improve overall effectiveness. To accomplish our objective, we:

- I. Determined whether the EQMS Program standards adequately addressed examination quality issues such as taxpayer rights, technical tax law application, timeliness of work, and customer relations/professionalism.
 - A. Reviewed the Small Business/Self-Employed Strategy and Program Plan and compared the strategic goals to the EQMS Program standards.
 - B. Compared revenue agents' and tax compliance officers' "critical job elements" to the EQMS Program standards to determine if they matched appropriately.
- II. Determined the effectiveness of the EQMS Program procedures, controls, and the sampling process in the quality assessment of examination cases.
 - A. Interviewed EQMS Program management and analyzed all available EQMS Program documentation to determine the sampling methodology and the monitoring system used for the sampling procedures.
 - B. Determined how the numbers of cases to be selected for sampling for both field and office examinations were identified and if they were statistically valid.
 - 1. Reviewed all 19 cases in 2 (Detroit and Los Angeles) of the 3 area offices visited that were excluded from the EQMS Program sampling process in a 1-day period to determine if they met EQMS Program exclusion criteria.
 - 2. Analyzed the closed case examination files for Fiscal Year (FY) 2001 to determine the EQMS Program-qualified population by area office.
 - 3. For the three areas visited, compared the number of cases that the current EQMS Program sample size should have been with the number of cases actually sampled to determine if the correct numbers were sampled.
 - 4. Determined the EQMS Program-qualified case population for 15 area offices (not including the International Office) by analyzing the closed case examination files for FY 2000 and comparing the total population to the total FY 2001 population. Since the FY 2000 population could not be broken down into areas, we adjusted the FY 2001 area populations to

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- account for the percentage decrease in the population that occurred from FY 2000 to FY 2001.
5. Calculated a statistically valid sample for each area office by using a 95 percent confidence level, a 50 percent expected error rate, and a plus or minus 5 percent precision.
 6. Compared the statistically valid sample size to the number of cases actually reviewed to determine if over- or under-sampling occurred.
 7. Calculated the number of review hours the EQMS Program used to review the over-sampled cases. Analyzed Table 37, Examination Program Monitor Report, and calculated the average hours per return and the average tax dollars per hour for both field and office examinations. Calculated the potential increased revenue (number of tax dollars assessed) that could have resulted by using the unnecessary overage of EQMS Program review hours to examine tax returns.
- C. Determined whether the deployment of EQMS Program results to the territory level would affect the current sampling process and its statistical validity.
1. Using the area office populations of EQMS Program-qualified cases, determined the qualified populations for 164 territory offices.
 2. Determined a statistically valid sample for each of the 164 territories by using a 95 percent confidence level, a 50 percent error rate, and a plus or minus 5 percent precision.
 3. Determined the percentage increase in sample size needed to bring statistically valid EQMS Program results to the territory level. Based on the increase in sample size needed, determined the number of additional reviewers required.
- III. Determined how effectively the results of the EQMS Program reviews were used to improve overall Examination effectiveness (training, new procedures, etc.).
- A. Compared the EQMS Program scores from the last 3 quarters of FY 2001 to the first 3 quarters of FY 2002 to determine if results improved. (Excluded the first quarter of FY 2001 [September 30 through December 31, 2000] since the EQMS Program standards and scoring system changed beginning January 2001.)
 - B. Interviewed three area directors, five territory managers, five group managers, and one Technical Support manager to determine when, what type, and how much feedback was given to revenue agents and tax compliance officers regarding EQMS Program results and reviewed all relevant documentation regarding this issue.

Major Contributors to This Report

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Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$9.8 million in assessed tax liabilities by using overage in staff hours for the Examination Quality Management System (EQMS) Program reviews to examine tax returns (see page 9.)

Methodology Used to Measure the Reported Benefit:

We conducted an analysis of Small Business/Self-Employed (SB/SE) Division closed examination files for Fiscal Years (FY) 2000 and 2001 to determine if the EQMS Program was reviewing the proper number of cases. These data were obtained through the Treasury Inspector General for Tax Administration (TIGTA) Data Central Warehouse from the Examination Closed Case Files and were originally provided to the TIGTA by SB/SE Division Examination Return Selection from the Audit Information Management System database.

The EQMS Program determined its current sample size (1 in 3 field and 1 in 5 office cases) from the previous year's (FY 2000) closed examination case population. Since the FY 2000 closed examination data are not broken down by area office, we had to simulate the FY 2000 populations by using FY 2001 closed examination data.

To accomplish this, we applied the same EQMS sampling criteria (type of returns reviewed) to the FY 2001 closed examination data, which we then were able to query by the 15 area office populations (the International Office was not included). We had determined that the number of EQMS Program-qualified returns examined nationwide decreased by 35 percent for field and 30 percent for office examinations from FY 2000 to FY 2001. Therefore, after we determined the number of EQMS Program-qualified cases by area office for FY 2001, we increased each area office population by these percentages to arrive at the simulated FY 2000 area office populations.

To further qualify our populations, we had to account for the fact that the Examination function closes cases by tax period and the EQMS Program reviews cases by key case (with all related returns attached). We determined the average number of tax periods (cases) per taxpayer by querying the related Taxpayer Identification Numbers from our total estimated FY 2000 EQMS Program-qualified population and arrived at ratios of 1.79 for field and 1.28 for office examination. We divided these ratios into each area population to arrive at our final estimated EQMS Program-qualified sample populations.

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We then computed what a statistically valid sample should have been for FY 2001 for each of the 15 area offices by using the simulated FY 2000 data and a confidence level of 95 percent, an expected error rate of 50 percent, and a precision rate of plus or minus 5 percent. We added the 15 sample sizes together and compared these results to the actual number of tax returns reviewed by the EQMS Program in FY 2001 and found that there were about 3,375 cases reviewed that were unnecessary for statistically valid area office results. A responsible management official indicated that, on average, 5 and 2.5 hours, respectively, were required to review a field and an office case, which resulted in approximately 12,385 extra hours used to review the cases.

We estimated that, by using these hours to examine more tax returns, the Internal Revenue Service could have assessed approximately \$9.8 million in tax liabilities in FY 2001. To arrive at this number, we used Table 37, Examination Program Monitoring report, from FY 2001 to compute the average number of hours spent to examine a tax return (31 for field and 8 for office examination) and the average dollar amount of assessed tax liabilities per tax return (\$30,795 for field and \$3,416 for office examination). Next, we divided the extra hours the EQMS Program unnecessarily spent reviewing tax returns (7,895 for field and 4,490 for office examination) by the average hours spent to examine a tax return. This resulted in 255 additional field and 561 additional office examination tax returns that could have been reviewed. Multiplying these additional tax returns by the average dollar per tax return resulted in potential assessments of about \$7.9 million for field and about \$1.9 million for office examination.

**Comparison of Estimated Statistically Valid
Territory and Area Office Samples**

Field Examination	Closed Cases³	Number of Reviewers Required⁴
EQMS Program-Qualified Cases	46,100	N/A
Valid Area Sample ¹	5,100	20
Valid Territory Sample ²	25,300	90
Percent Increase	396%	N/A
Office Examination	Closed Cases	Number of Reviewers Required
EQMS Program-Qualified Cases	78,500	N/A
Valid Area Sample	5,300	10
Valid Territory Sample	28,200	50
Percent Increase	432%	N/A

Source: Examination Closed Data Files/FY 2001.

¹Valid area sample based on Fiscal Year (FY) 2001 closed cases and a 95 percent confidence level (CL), a 50 percent expected error rate, and a plus or minus 5 percent precision rate.

²Valid territory sample based on a 95 percent CL, an expected error rate of 50 percent, and a plus or minus 5 percent precision rate.

³Based on all Small Business/Self-Employed (SB/SE) Division area offices (excluding the International Office) and 164 SB/SE Division territory offices for FY 2001. Numbers in this column are rounded to the nearest one hundredth for estimation purposes.

⁴Based on 2,080 hours per year times 70 percent direct time (per EQMS Program management) and 5 hours or 2.5 hours per case, respectively, for field and office examinations – 1 staff person can review approximately 291 field cases or 582 office cases per year. Numbers in this column are rounded to the nearest tenth for estimation purposes.

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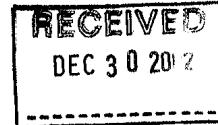
Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DEC 30 2002



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

Joseph G. Kehoe
Joseph G. Kehoe
Commissioner, Small Business/Self-Employed Division

SUBJECT:

Draft Report – The Examination Quality Measurement
System Program Can Be Enhanced (Audit # 200230021)

I have reviewed your report and agree we must improve the Examination Quality Measurement System (EQMS) Program; however, I do not agree with your outcome measures. The overall objective of your review was to determine whether the EQMS Program effectively measures the quality of the Examination function's work and if we use the results to improve overall effectiveness.

Your report estimated that we could have assessed an additional \$9.8 million in tax liability if we had not reviewed more cases than the sample required. Your report also indicated that if we were not reviewing cases, we should be assessing taxes. We assign our reviewers in EQMS for a specific period of time; we do not shift reviewers between reviewing and examining returns. Our reviewers are also responsible for providing support to the field in understanding the EQMS standards and applications through conducting presentations, attending group meetings, and various other activities. The Compliance initiatives in FY 2003 Business Plan require examination of more complex returns, which will require even more in-depth reviews than we conducted during the period your report covers.

The EQMS Program is the Small Business/Self-Employed (SB/SE) Division's process to measure examination quality and assess long-term trends of performance, in keeping with the Internal Revenue Service's (IRS) balanced measures. We use the EQMS Program's results to identify national trends, system changes, and training needs; to establish baselines; and to provide an understanding of the quality of examinations. The EQMS Program conducts reviews of a statistically valid sample of completed examination cases, based on certain standard criteria.

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We are always looking for ways to improve our processes and enhance quality. Some of our current efforts include:

- Evaluating the EQMS quality standards and process measures to ensure they reflect the goals of the re-engineering activities and the cases being reviewed represent the current workload mix closed by Examination personnel.
- Effectively using the EQMS Program results to help improve overall examination quality; the Examination function's overall quality improved by a rate of five percent for field examination cases and one percent for office examination cases from the end of Fiscal Year 2001 through the first three quarters of fiscal year 2002.
- Working with the Case Processing and Technical Support functions to establish their specific roles and responsibilities that impact cases reviewed by the EQMS.
- Advising the Case Processing and Technical Support Functions on how to use the results from the completed case reviews to improve performance.

As a result of these efforts, the majority of the Case Processing sites successfully identify and process the cases to be sampled. The partnership between the staffs of the EQMS and Technical Support has led to overall improved quality in the Examination function.

In addition, your report indicated an adequately documented sampling process was not available, which impacted the EQMS ability to monitor and/or make periodic adjustments to the sample size when needed. We agree with your assessment; however, several significant events occurred that hampered the ability to effectively monitor the sampling process, such as:

- Information on the sample size was not readily available because of the re-organization of the IRS and "stand-up" of SB/SE Division and we could not convert district/branch closures into area and territory configurations because of the steady rate of changes. The rate of closures by Examination was decreasing for a variety of reasons.
- We had not completed all changes to IT systems because of the standup and therefore, could not determine the correct number of closures by area and territory to determine the appropriate sampling size.

Our comments on the recommendations follow:

RECOMMENDATION 1

The Director, Compliance SB/SE Division should resubmit the RIS to automate the sampling process to help ensure all qualified cases are selected for review, thus helping to promote statistical validity. The RIS should contain a business case explaining that such a selection process is necessary to ensure that the SB/SE Division can meet its goal of adequately measuring its business results under the balanced measures concept.

ASSESSMENT OF CAUSE

Two case processing sites did not correctly identify all cases that they should have selected for sampling.

CORRECTIVE ACTION

EQMS management recognized the need for an automated system and submitted a RIS on October 10, 2002, to request automation support. In addition, the Compliance Support Design Team is considering automating the EQMS sampling process.

IMPLEMENTATION DATE

Completed

RESPONSIBLE OFFICIAL (S)

Director, Case Management; SB/SE Division
Director, SRPM; SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

The Director, Compliance, SB/SE Division should re-emphasize the criteria for cases qualifying for the EQMS Program Sampling and the need for reviews so that all cases meeting the criteria are being properly identified until such time when electronic sampling is implemented.

ASSESSMENT OF CAUSE

Two case processing sites did not correctly identify all cases that they should have selected for sampling.

CORRECTIVE ACTION

The Director, Case Management will re-issue the sampling procedures and expectations to all Case Processing sites. The Director, Case Management assisted by the Director, Strategy-Research Performance Management will

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provide training and assistance visits to the Case Processing sites to ensure consistent and correct application of the sampling procedures.

IMPLEMENTATION DATE

March 31, 2003

RESPONSIBLE OFFICIAL (S)

Director, Case Management; SB/SE Division

Director, SRPM; SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Program Manager for EQMS and Chief, Performance Excellence will inform the Director, Case Management and Director SRPM on the status of the corrective action.

RECOMMENDATION 3 and 4

The Director, Compliance, SB/SE Division should establish and document an approved sampling plan that ensures statistical validity, periodically evaluate the plan, and make appropriate revisions.

The Director, Compliance, SB/SE Division should ensure that the EQMS Program only review the number of cases needed to constitute a statistically valid sample.

ASSESSMENT OF CAUSE

The current sample plan has been in effect since October 2000. We have not made changes to the sample plan because of the reorganization of Area and Territory Offices. Monitoring the sample process is systemically difficult because the AIMS closed case report does not clearly represent the sample population in total.

CORRECTIVE ACTION

The EQMS Program Manager will maintain a documented sampling plan at all times. We will monitor the sampling process with assistance from the Office of Centralized Workload Selection & Delivery and Performance Excellence and make any necessary periodic adjustments.

IMPLEMENTATION DATE

March 31, 2003

RESPONSIBLE OFFICIAL(S)

Director, Case Management; SB/SE Division

Director, Centralized Workload Selection and Delivery; SB/SE Division

Director, SRPM; SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Program Manager for EQMS and Chief, Performance Excellence will inform the Director, Case Management and Director SRPM on the status of the corrective action.

RECOMMENDATION 5

The Director, Compliance, SB/SE Division, should evaluate the impact that valid territory office statistical sampling would entail to ensure the expected benefits justify the additional resources that would be needed.

ASSESSMENT OF CAUSE

The current EQMS Program sampling plan produces results that are valid at the area office level. We do not have a sampling plan at the territory level.

CORRECTIVE ACTION

SB/SE will re-evaluate the impact statistically valid territory level sampling will have on staffing levels. This evaluation will also include a discussion of the impact on Balanced Measures.

IMPLEMENTATION DATE

June 30, 2003

RESPONSIBLE OFFICIAL (S)

Director, Compliance
Director, SRPM

CORRECTIVE ACTION MONITORING PLAN

The Program Manager for EQMS and Chief, Performance Excellence will inform the Director, Case Management and Director, SRPM on the status of the corrective action.

RECOMMENDATION 6

The Director, Compliance, SB/SE Division, should consider providing individual feedback to examiners from the EQMS Program case reviews, after resolving this issue with the NTEU.

ASSESSMENT OF CAUSE

We do not give the EQMS results to employees according to an agreement with NTEU.

CORRECTIVE ACTION

We agree with the need to share as much feedback with the examiners as possible and will pursue resolution of this issue with NTEU. In the interim, all

The Examination Quality Measurement System Program Can Be Enhanced

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levels of management will review the results of EQMS and share them generally with the examiners to improve performance.

IMPLEMENTATION DATE

September 30, 2003

RESPONSIBLE OFFICIAL (S)

Director, Compliance; SB/SE Division

Director, SRPM; SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Program Manager of EQMS and Chief, Performance Excellence will inform the Director, Case Management and Director, SRPM on the status of the corrective action.

If you have questions, call me at (202) 622-0600 or Rebecca Chiaramida, Deputy Director, Compliance Services, SB/SE Division, at (859) 669-5720.